VZCZCXRO1247
OO RUEHROV
DE RUEHDS #0910/01 0931421
ZNR UUUUU ZZH
O 021421Z APR 08
FM AMEMBASSY ADDIS ABABA
TO RUEHC/SECSTATE WASHDC IMMEDIATE 0139
INFO RUCNIAD/IGAD COLLECTIVE PRIORITY
RUCPDOC/DEPT OF COMMERCE WASHDC PRIORITY
RUEWMFD/HQ USAFRICOM STUTTGART GE PRIORITY
RUEATRS/DEPT OF TREASURY WASHINGTON DC PRIORITY
RUEAIIA/CIA WASHINGTON DC PRIORITY
RUEHRC/DEPT OF AGRICULTURE WASHINGTON DC PRIORITY
RHMFISS/CJTF HOA PRIORITY
RUEHLMC/MILLENNIUM CHALLENGE CORP WASHINGTON DC PRIORITY 0107
RUEKDIA/DIA WASHINGTON DC PRIORITY
RHMFIUU/HQ USCENTCOM MACDILL AFB FL PRIORITY
RUEKJCS/JOINT STAFF WASHINGTON DC PRIORITY
RHEHNSC/NSC WASHDC PRIORITY
RUEKJCS/SECDEF WASHINGTON DC PRIORITY

UNCLAS SECTION 01 OF 03 ADDIS ABABA 000910

SIPDIS

SENSITIVE
SIPDIS

E.O. 12958: N/A
TAGS: ECON EFIN PGOV EAGR ET
SUBJECT: ETHIOPIA: TIGHTER GOVERNMENT OVERSIGHT OF THE
ECONOMY

SUMMARY

¶1. (SBU) In his March 18 performance report of the government to the House of People's Representatives, Prime Minister Meles Zenawi avoided commenting on political, security, or foreign policy dynamics focusing his comments instead on the state of the economy. Meles' main points were that the Ethiopian economy is essentially healthy, but sustained high inflation is "public enemy number one," so the Ethiopian government (GoE) is playing an increasingly active role to respond. Meles' argued that to respond to the causes of Ethiopian inflation -- namely high world prices, excess liquidity in the economy, and backward and cumbersome agricultural marketing systems -- the GoE will: 1) continue and expand subsidies on food and fuel, 2) take appropriate fiscal and monetary policy "measures," 3) encourage the people to form "consumer associations" to which the GoE will ensure distribution of goods at "reasonable prices" through state enterprises, and 4) create a Task Force, composed of the federal police, trade ministry, and intelligence service to "permanently monitor illicit (business) activity" which will rely broadly on public "tip-offs." While the GoE's attention to mounting inflation is certainly needed, policy prescription focused overwhelmingly on unsustainable government interventions in the economy are neither fiscally sustainable or consistent with the slow transformation of GoE public statements in recent years that have shed Marxist ideology in favor of a model of a developmental state that supports a market-oriented economy. End Summary.

IT'S PARTLY ABOUT WORLD INFLATION...

¶2. (U) Prime Minister Meles began his presentation to Parliament by noting that the GoE had set two economic goals for the current fiscal year: maintaining an economic growth rate of at least 10 percent and increasing exports by at least 25 percent. Meles reported that, to date, the Ethiopian economy is on track to register 10.8 percent economic growth this year with a 32 percent increase in

exports over the past eight months. Despite these achievements, the GoE has not been able yet to advance toward two additional goals: stabilizing the price of commodities and controlling inflation. The Prime Minister argued that there are three major dynamics contributing to the approximately 20 percent persistent inflation that Ethiopia has seen over the past two years. First, world prices, particularly for steel, cement, grains, and fuel, are at historic levels. Meles attributed this to increased demand from China and India, the practice of pricing world oil prices in U.S. dollars, and the habit of "exploitative businessmen" hoarding supply stocks during periods of price peaks. In response to this challenge, Meles detailed GoE efforts to shift toward domestic production, where possible, to replace imported items such as crops and cement. Noting that these steps would only yield longer term results, the Prime Minister highlighted that the GoE has spent over 4.2 billion Birr (roughly $500 million) in recent months to subsidize fuel and wheat prices, and has eliminated the import duty on cement, as short term solutions. In light of the persistent inflationary pressures, Meles stated that the GoE had no option but to continue, and expand, the policy of subsidization. In particular, the GoE will continue to provide subsidized wheat and edible oil to low income urban dwellers. Rather than expose the public to the shock of world oil prices, Meles affirmed that the GoE will continue the policy of step-by-step alignment of local and world fuel prices. As a new initiative, the GoE will also now lift the Value Added Tax and Turn Over Tax on grains.

...EXACERBATED BY DOMESTIC DYNAMICS

¶3. (U) Meles also noted that the increase in the amount of money in circulation in Ethiopia is also a significant contributing factor fueling inflation. Meles matter-of-factly acknowledged that negative real interest

rates (currently roughly negative 14 percent) are contributing to excess liquidity in the economy, but at the same time argued that the broad profitability of Ethiopian businesses means that borrowers are repaying their loans and driving up deposits held by banks. He noted that despite a central bank regulation in summer 2007 requiring banks to double their reserve requirements from 5 percent to 10 percent, this intervention had not been fully successful in mopping up excess liquidity. Appearing to pre-emptively deflect criticism, Meles flagged that GoE borrowing to cover the budget deficit has been maintained at a level of only 2.7 percent. He did not, however, specifically address questions as to what had caused the excess currency in circulation. Without providing specific details, the Prime Minister confirmed that the Finance Ministry would "take measures" to strengthen National Bank of Ethiopia (NBE, Ethiopia's central bank) efforts to restrict the growth of money supply.

¶4. (SBU) Meles also acknowledged the "backward and cumbersome" agricultural marketing system as one of the main causes of inflation. Again, without discussing the specific challenges of the system in place or how it would be rectified, Meles made passing reference to the expected opening this year of the long delayed commodities exchange before moving on to detail one of the speech's main initiatives -- consumer associations. Again without detail, Meles asserted that the GoE will now urge the public to organize themselves into "consumer associations" to enable them to buy basic goods at reasonable prices. Meles said that the associations would hold elections to provide for control by the members. The GoE's role would be limited to "ensuring the distribution of goods to the associations at reasonable prices through state enterprises." The Prime Minister did not clarify whether existing state enterprises would be sufficient to fill this role or if new parastatals would be required.

¶5. (SBU) Meles next moved on to highlight the role of illicit businessmen who seek to enrich themselves illegally through exploiting market opportunities. While he refrained from invoking his oft-used label of "rent seekers," he was quick to chastise those who try to benefit inappropriately from the prevailing situation. Meles noted that the GoE had long recognized the challenges and costs of pursuing all cases of market exploitation and, as such, had pursued a policy of cracking down on the egregious offenders in an effort to set an example adequate to induce others to refrain from illegal operations. This approach, Meles lamented, had clearly failed. In response, the GoE is establishing a Task Force, composed of the Ministry of Trade and Industry, the Federal Police, and the National Security and Intelligence Service to "permanently monitor illicit activities" and prosecute all serious offenders. Similar structures would be introduced in the regional states and major cities as well. The Task Force, Meles emphasized, would depend heavily on the public to provide "tip-offs" about offenders.

COMMENT

¶6. (SBU) Despite having initially been founded as the Marxist-Leninist League of Tigray, and espousing heavily-statist economic policies, the ruling Ethiopian People's Revolutionary Democratic Front (EPRDF) increasingly has adopted public references to market-oriented economic reforms in recent years. Nevertheless, the policy response that the Prime Minister presented to tackle the persistent challenge of high inflation suggests that the GoE continues to be led more by vestiges of this ideological orientation in addressing economic challenges than by creating a conducive environment for competition to improve market efficiencies. While Meles often invoked fuzzy economics around the details, his broader arguments pertaining to the causes of high Ethiopian inflation were generally sound. Still, his suggestion that conventional western economic thought is flawed -- as evidenced by the observed increase in bank deposits despite negative real interest rates -- highlights a common sentiment held among ruling party hardliners and helps

explain the government's continued reliance on a strong government role in the economy. The Prime Minister made no mention of increasing interest rates to mop up excess liquidity or of steps that could rid markets, particularly agricultural, of inefficiencies caused by the very state enterprises trumpeted or bureaucratic regulations imposing trade through middlemen and government approved traders. It is encouraging that the GoE is finally addressing problems within Ethiopia's macroeconomic fundamentals, but overbearing oversight and micromanagement of the economy present more causes for concern than hope for a resolution. End Comment.
YAMAMOTO